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FOREIGN SERVICE DESPATCH

(Security Classification)

FROM : Amembassy TEHRAN

834

862a or 88/5-1459

TO : THE DEPARTMENT OF STATE, WASHINGTON.

DATE

REF : CERP-Iran: Section D, Item 1-AcB

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<i>67</i>	ACTION	DEPT.
For DPA Use Only	REC'D	FROM OTHER
5/25/59 106-5 107 TEL 3 FEB 3 XMB-4 TAR-2		
SUBJECT: Dr. Erhard's Economic Mission to Iran 6/8/59 USIA 10 1,913-5 19 MAY 4 NAVF-3 AIR-1		

SUMMARY

During the period May 1 to May 5, 1959 a German economic mission headed by German Minister of Economics, Dr. Ludwig ERHARD, visited Tehran. At the conclusion of this visit a seven-point protocol was signed by both parties which reflected general areas of agreement which had been reached with regard to German economic activity in Iran. It is clear from information subsequently made available to the Embassy however, that the protocol, which was only made public in paraphrase, failed to cover completely all issues discussed between the two parties. While the protocol noted the willingness of the German Government to guarantee private German credit to Iran for a steel mill, it failed to note Dr. Erhard's expressed interest in Iran's plans for a petroleum pipeline from Abadan to Khor Musa (on the channel to Bandar 'Ashur) or German willingness to extend financial aid to Iran for a low-cost housing project. A combination of relevant factors, which are noted in the body of this despatch, has also led the Embassy to speculate that Dr. Erhard's mission may portend German intentions to enter the Middle East oil picture, in Iran.

* * * * *

Dr. Erhard arrived at Tehran on May 1 accompanied by two deputies of the Bundestag, two ranking officials of the Ministry of Foreign Affairs and two senior officers of the Ministry of Economics. On the following day Dr. Erhard had lunch with the Shah. The following issues were discussed at this luncheon:

1. The Shah expressed the hope that Germany would give Iran financial assistance for the construction of a steel mill.
2. The Shah emphasized Iran's great need for low-cost housing and asked for German financial assistance to provide such housing.
3. Dr. Erhard expressed great interest in Iran's plans for a petroleum pipeline from Abadan to Khor Musa and said that he hoped Germany would get the contract for its construction.

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Apparently neither the Shah or Dr. Erhard was prepared to settle these issues on the spot and, in fact, Dr. Erhard was completely unprepared, because of deficient German Embassy briefing, to respond to the Shah's housing request. Nevertheless general agreement was reached that these issues could be settled, probably on a quid pro quo basis.

Detailed negotiations of issues raised at the Shah's luncheon as well as other matters of mutual interest were carried out from May 2 to May 4 between the German mission and an Iranian team headed by Germanophile Jafar SHAPIF-EPA'IL, Minister of Industries and Mines. The Iranian team also included Minister of Finance Ali Asgar NASEP and Deputy Prime Minister for Economic Affairs Ali 'A'SIP.

Negotiations and Results

As the result of the discussions carried out between the German mission and the Iranian team a seven-point economic protocol was signed by both parties. This protocol has not been made available to the Embassy but a composite of the paraphrased version released to the press which appeared in Persian, French and English has been prepared and is enclosed. Several points of agreement reached between the two parties are not included in this protocol and the wording of some of the items which are included is somewhat misleading. Sketched below is the Embassy's understanding of the meaning of the protocol, as well as points of agreement which are not included in the protocol, as obtained from German and Iranian officials.

1. The Iranians initially requested German financial assistance to build a steel mill, which would proceed through three stages of construction with the final stage bringing plant capacity to 260 thousand tons of raw steel per year. On the face of it a project of this size would cost approximately 800 million DM. After considerable discussion both sides came to the conclusion that a project of this size was much too grandiose for Iran's needs or resources and that it would be wiser to start from the processing end with a rolling mill. The Germans then agreed to provide German Government guarantees of private German credit for 360 million DM for a 260 thousand ton (rated capacity) rolling mill. This agreement is reflected in the protocol although neither the specific purpose, i.e. rolling mill, nor the sum is mentioned.

Embassy Comment:

The Embassy's despatch 697 of March 30, 1959 reviewed developments affecting Iran's steel mill project up to that time. Representatives of Demag-Krupp had then just concluded another round of

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negotiations with Iranian Government and Plan Organization officials and had left Iran after promising that Demag-Krupp would be willing to support the project by contributing 20 per cent of the equity capital on a participation basis. This promise, however, was on the condition that Demag-Krupp would be able to obtain German Government guarantee of its contribution. German equity participation had long been a point Iran had insisted on before it would sign a contract with Demag-Krupp for the construction of the steel mill. Shifting financial conditions of the Plan Organization, however, threatened to make the German concession a hollow victory as it became clear that Iranian funds were not available, without diversion from other projects, to make a final commitment on the project. Grave doubts were also raised by the Economic Bureau of the Plan Organization as to the economic feasibility of moving ahead without further investigation of Iran's total financial and mineral resources.

Demag-Krupp officials returned to Tehran, at the same time Dr. Erhard arrived, for further talks with the P.O. It is not yet clear whether the German Government offer to guarantee credit will also cover Demag-Krupp participation.

2. With regard to Iran's request for financial aid for a low-cost housing project the Germans noted that Iran has a credit of some 7 million DM which arose out of an old Reichsmark clearing agreement. It had previously been agreed between the two countries that this credit would be used for German technical assistance. The Germans said, however, that Iran's wish to use 5.8 million DM of this credit for its housing program could form the base for further discussion.

Embassy Comment:

The shortage of adequate low-cost housing is one of the Shah's pet concerns and he often mentions it to foreign visitors, especially if they're potential sources of financial assistance. Embassy despatch 747 of April 20, 1959 discusses developments in this field which include the formation of a National Housing Authority and its plans for the erection of 2000-unit block apartment houses in Tehran. USOM has already been approached for financial assistance for this project.

3. It was agreed that the German Government would furnish, at its expense, German geologists to continue the mineral survey work they had started in the Kerman area. An Iranian request for assistance to study mineral explications possibilities, including the construction of a railroad or first class road from the area to the port of Bandar Abbas, was put off with the explanation that the

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resources survey would have to be completed first.

Embassy Comment:

Over a year ago several German geologists were sent to Iran, at German Government expense, to conduct a survey of mineral resources in the Kerman area. This group was under the direction of the Ministry of Industries and Mines. After the team was in the field for some time the then Director of the Plan Organization EBTEVAJ signed a contract with the U.S. Ebasco-Alien group to carry out an economic development program in the Kerman area, which included a survey of the area's mineral resources. This contract, which in effect called for a duplication of effort, caused the Germans to retire. Following Ebtevaj's downfall in February the Ministry of Industries and Mines asked the Germans to return. Ebasco has, in the meantime, ceased its work at the request of the P.O.

4. A Ministry of Customs and Monopolies request for boats for its anti-smuggling mission in the Persian Gulf was met by German agreement that, if further studies justified additional equipment, the German Government would be willing to guarantee private German credit for up to 5 million DM for the purchase of 100 motor boats and 20 tug boats.

Embassy Comment:

The Ministry of Customs and Monopolies has been concerned for some time over its inability to cope with smuggling activities in the Persian Gulf. This problem has been the subject of unofficial discussions between the Ministry and U.S. Treasury and USCG officials. In March 1959 Admiral COMAPT of the USCG visited Iran and made a survey of the situation in the Ahadan-Khorramshahr area, but the result of his visit is not yet known to the Embassy. It is probable, however, that the Ministry believes additional motor boats (it now has 9 Italian boats) are needed for its anti-smuggling mission and raised the matter with the German mission.

5. The German Government agreed to give Iran 1 million DM for the creation of a professional (technical) school. It also agreed to train experts for Iran's Institute of Geology.

6. Germany agreed to send, at its expense, one railroad traffic and tariff expert to Iran to work for the Ministry of Roads and Communications.

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7. Dr. Erhard told the Iranians that he would make new efforts to resolve the double taxation issue which affects Iranian merchants established at Hamburg. He pointed out, however, that these merchants have not supplied the German Government with sufficient information to support proposed legislation now being drawn up by the Government for introduction into the Bundestag.

8. Both sides agreed to the formation of a six-man committee (three Iranians and three Germans) to resolve the Fordowai Department Store question (see EmbDesp 799, May 4, 1959).

9. Following discussion of the points noted above Dr. Erhard raised the question of the Abadan-Khor Musa pipeline. He noted that a German consortium had submitted a bid for this contract and expressed strong hope that it would be awarded to the German company. Iran replied that the pipeline contract had been put out for international bid and that it must abide by the usual practice of awarding the contract to the lowest bidder. Apparently Dr. Erhard was quite insistent on this issue and Iran finally said that if German performance on other points of agreement was satisfactory, especially steel mill financing, then Iran might consider throwing out all bids and coming to a Government-to-Government agreement on the project. As far as it can be determined negotiation on this subject ended on this rather inconclusive note although CAS reports that the Shah, prior to his departure on a state visit to England only two days after Dr. Erhard had arrived in Tehran, gave orders to award the pipeline contract to Germany.

Embassy Comment:

The development of events in Iraq following the July 14th coup did not raise Iranian fears that the flow of oil from its loading facilities on the Shatt-el-Arab might be interrupted and caused Iran hastily to devise a plan to build a pipeline system from Abadan to Khor Musa on the channel to Pander Meshur. International bids were solicited from 15 firms and 10, including one from a German consortium, were received. The NIOC, which has prime responsibility for planning the project apparently has had second thoughts on the subject and is now thinking along the lines of pipelines which would carry only residual fuel oil and diesel oil—a project much scaled down from the all purpose pipeline complex originally contemplated. This project is the subject of a separate despatch now being prepared by the Embassy.

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German Economic Objectives in Iran

While German response to Iranian requests for economic assistance is in itself significant, it struck the Embassy that none of these issues seem of sufficient importance to have required Dr. Erhard's presence in Iran. Financing of the steel mill was Iran's most important request and Dr. Erhard's response, which could have easily been made from Bonn, indicates that implementation of the project largely turns on financing and construction details to be worked out between Demag-Krupp and the Plan Organization. The fact that Dr. Erhard left Germany at a time when internal and external events, which bear directly on his future, were developing rapidly suggests that his mission was of more importance than meets the eye. It might also be noted that Dr. Erhard passed up two recent occasions to visit Iran when the steel mill and pipeline issues were not much less advanced than they are at present. In view of Dr. Erhard's unexpected initiative in referring to Iran's Abadan-Khor Musa pipeline plans and his insistence that Germany be awarded the contract for its construction, it occurs to the Embassy that Dr. Erhard's primary mission was to gain German entry into the Middle East oil picture, in Iran. The Embassy is unable to judge whether this entry would include Iranian oil concessions but it is evident that the pipeline contract itself would entail Germany advancing credit in the order of 240 million DM.

COMMENT

Regardless of German intentions vis-a-vis Iran's oil it is clear from the results of Dr. Erhard's mission that German economic policy toward Iran has taken a radical turn. Participation in the steel mill and pipeline projects implies German Government willingness to provide or make possible, through guarantees, mobilization of venture capital in the order of \$200-million for investment in Iran over the next four to five years. This is in marked contrast to the attitude assumed by Dr. ADENAUER during his Iranian visit in March 1957, when he dodged all questions of financial aid (see Embdesp R99, April 9, 1957).

Approved By:

M. R. Rutherford
First Secretary of Embassy

FOR THE AMBASSADOR:

Jack C. Miklos
Second Secretary of Embassy

Enclosure:

Paraphrase text of German-Iranian Economic Protocol of May 1, 1959

Copies to: Consulates Isfahan, Khorramshahr, Meshed, Tabriz
Ambassies Bonn, London

Contributor: Norbert Heilpern, 11577/1

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Paraphrase text of German-Iranian Economic Protocol
of May 4, 1959

1. Dr. Erhard, on behalf of the Government of the German Federal Republic, has reached general agreement (with the Government of Iran) with regard to the extension of facilities required to obtain credit for the plans, construction and projects related to a steel mill for Iran. General agreement was also reached with regard to the investment of German industrial capital. Details of this agreement are to be worked out at a later date.
2. The German Federal Republic agrees to extend credit facilities for the purchase of 100 motor boats and 20 tug boats for the Iranian Ministry of Customs and Monopolies.
3. The German Minister of Economics agrees to send to Iran a first class transportation expert.
4. The German Federal Republic will put at the disposition of the Government of Iran the sum of one million DM for the creation of a professional (technical) school. It is also ready to train experts for the (Iranian) Institute of Geology.
5. With regard to the economic development of the Kerman area the two parties agree to the continuation of the prospecting and study work of the German group.
6. Dr. Erhard assures the Government of Iran that with regard to financial problems (double taxation) being encountered by Iranian merchants established at Hamburg the German Government will take the required measures to definitively resolve the problem.
7. The two parties agree to seek a friendly and equitable solution to the Ferdowsi Department Store question.

END OF ENCLOSURE ONE

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